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August 13, 2007

Ms. Gail McLarnon
U.S. Department of Education
Room 8026
1990 K Street NW
Washington, DC 20006-8542

Dear Ms. McLarnon:

The California Attorney General's Office ("Attorney General") appreciates the opportunity to submit the following comments on the proposed regulations published in the Notice of Proposed Rulemaking (NPRM) by the Department of Education ("Department") beginning on page 32410 in the June 12, 2007 *Federal Register*.

If the Department has any questions about the Attorney General's recommendations or comments, please contact me.

Sincerely,

A handwritten signature in cursive script, reading "Margaret Reiter", is positioned above the printed name.

MARGARET E. REITER
Supervising Deputy Attorney General

For EDMUND G. BROWN JR.
Attorney General

MER:act

**Before The
DEPARTMENT OF EDUCATION
Washington, DC 20006**

In the Matter of:)	
)	ED-2007-OPE-0133
Federal Perkins Loan Program, Federal)	
Family Education Loan Program, and)	
William D. Ford Federal Direct Loan)	
Program: Notice of Proposed Rulemaking.)	

**COMMENTS OF
THE CALIFORNIA ATTORNEY GENERAL**

August 13, 2007

The California Attorney General's Office ("Attorney General") submits the following comments in response to the proposed regulations published in the Notice of Proposed Rulemaking (NPRM) by the Department of Education ("Department") in the June 12, 2007 *Federal Register*. The parenthetical page references below are to the June 12, 2007 *Federal Register*.

Prohibited Inducements (pp. 32420-32424, 32438-441; 34 C.F.R. §§ 682.200, 682.209(k), 682.401)

Incorporation of FTC's Holder Rule

The Attorney General supports the incorporation of the Federal Trade Commission's (FTC's) Holder Rule into the federal student loan regulations, which would have the effect of making the FTC's Holder Rule apply to all loans made under the Federal Family Education Loan Program (FFELP). The FTC's Holder Rule is a fundamental consumer protection rule that applies to lenders that have close relationships with sellers of consumer goods or services. Under the FTC's Holder Rule, a lender who finances a sales transaction is subject to the claims and defenses to payment that a consumer could assert against the seller. In its nearly 40-year history, the FTC's Holder Rule has substantially reduced consumer fraud because lenders, deprived of holder-in-due-course status, are careful to avoid financial the operations of unscrupulous sellers -- in this case, schools that fail to deliver the quality of education that was promised to student borrowers. Based on the Attorney General's experience, disreputable schools will often close, leaving students to face repayment obligations to lenders who had effectively financed the operation of the closely affiliated schools. For this reason, student borrowers need to be able to assert the same claims against the holders of their loans as they can against their schools.

While the Attorney General supports the incorporation of the FTC's Holder Rule into the federal student loan regulations for the reasons cited above, the Attorney General is concerned that the current wording of the proposed regulation lends itself to a too-narrow interpretation that could limit the borrower's claims and defenses against the holder of the loan, contrary to the letter and the spirit of the FTC's Holder Rule. In particular, the proposed regulation allows a borrower to assert claims and defenses against "[a]ny lender holding a [FFELP] loan". (34 C.F.R. § 682.209(k) [proposed] (emphasis added).) In contrast, the FTC's Holder Rule refers to "any *holder* of this consumer credit contract". (16 C.F.R. 433.2 (2006) (emphasis added).) To the extent the proposed language could be argued to apply only to the initial lender, it would be much narrower than the FTC's Holder Rule. Borrowers need to be able to raise claims against whichever entity is currently holding their student loans, including investors and others operating in the secondary market, even if that holder is not the initial lender; otherwise, an unscrupulous lender could cut off a student borrower's defenses or claim by simply selling the loan quickly.

Secondly, the Department's proposed regulation states that "any lender holding a loan is subject to all claims and defenses that the borrower could assert against the school *with respect to that loan*." (34 C.F.R. § 682.209(k) [proposed] (emphasis added).) The language proposed could be argued to allow borrowers to assert claims and defenses against the lender only if the nature of the borrower's complaint is itself related to the loan and not to any other aspect of the school (e.g., the institution's accreditation or job placement claims). This constricted interpretation is clearly

contrary to the intent and purpose of the FTC's Holder Rule, which is meant to give consumers the protection of asserting all the claims and defenses against the holder of the loan that they could assert against the seller. Indeed, the FTC's Holder Rule does not contain language limiting the borrower's claims and defenses to just those related to the loan.¹

It is important that borrowers' defenses to repayment of federal student loans are clearly defined and mirror the language of the FTC's Holder Rule, since as the preamble suggests, it is the Department's intent to incorporate the FTC's Holder Rule into the existing regulations. In order to forestall narrow construction and any possible undermining of borrowers' rights to make claims against holders of their student loans, however, the Attorney General strongly recommends that the Department use the FTC's Holder Rule language "Any holder of a loan" in place of the phrase "Any lender holding a loan" in proposed Section 682.209(k). Additionally, the Attorney General strongly recommends that the phrase "with respect to that loan" be stricken from proposed Section 682.209(k). Thus, proposed Section 682.209(k) would read, in part, as follows: "(k) Any holder of a loan is subject to all claims and defenses that the borrower could assert against the school ~~with respect to that loan . . .~~"

1. The FTC's Holder Rule reads, in relevant part, "ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS THEREOF. . . ." 16 C.F.R. § 433.2 (2006).